Stress, Stress And More Stress

by Steve Brown

We heard a story not too long ago from a CFO who commented that it was sometimes difficult to get work done during banking hours because his office was situated near the lobby. It seems customers kept poking their heads in to say hello. This article is not going to focus on whether or not the customer is always right, however. Instead, we want to point out that the job of the CFO is difficult and like chief risk officers, not only is the institution at risk if there are errors in judgment, there can be personal liability as well.

Part of the difficulty for any CFO is keeping up with new rules and regulations. For instance, the Fed released new rules for stress testing for large banks in March. At the same time it also announced the results of the stress test for the 30 largest institutions in the country and most passed.

Of note, there were 5 banks that failed the test including Citigroup (2nd failure in 3Ys), HSBC North America Holdings, Royal Bank of Scotland, Banco Santander and Zions. At issue, failure of this test means those banks' ability to increase dividends and repurchase shares is negatively impacted. Reasons differed among the banks for their failure, but the impact on flexibility was felt by all as a result.

For community banks reading this, we note the Fed's stress scenario is severe: a peak unemployment rate of 12.1%, a drop in equity prices of more than 50% and a decline in housing prices greater than 20%. The Fed reminds us that these projections should not be considered expected or likely outcomes, but rather as possible hypothetical results in severely adverse conditions. The purpose of the test is to find out whether these large institutions will endanger the broader financial system.

Community banks mostly don't need to worry about the level of scrutiny that has been applied to the largest banks. But in light of the new rules for the big banks, it is a good time for smaller banks to review OCC Bulletin 2012-33 (provides guidance for banks under $10B). The bulletin suggests that most banks should do some form of stress testing or sensitivity analysis of loan portfolios on at least an annual basis and as a part of a sound risk management process.

The bulletin also highlights elements of a good process including the use of "what-if" scenarios to illustrate vulnerabilities, so management teams can understand what impact a stress event might have on earnings and capital and to incorporate the resulting analysis into the bank's overall risk management process, ALM, strategic and capital planning processes.

The level of complexity of a bank determines how rigorous the analysis should be. From a regulatory viewpoint, banks with more complex portfolios and greater concentrations of CRE are expected to undertake a more robust process to manage concentrations and the risk in their portfolios.

Managing risk in any bank is complex and time-consuming, yet it remains important. Understanding the impact on credit, liquidity and capital when an adverse situation occurs is the first step to building a plan and preparing. One way to get this job completed efficiently is to hire a consultant (we offer this service) and bring in outside expertise in technical areas as you free up time.

As for our beleaguered CFO with the office near the door, we think speaking to customers is really important. To win the fight against larger banks, happy staff that is accessible to customers is a welcome sight indeed. If you want help with stress testing your credit, rate risk and liquidity against your capital call us. If you want help with stress related to customers popping in to say hello, consider the alternative and smile!

BANK NEWS

Going Upscale

The NAR reports the net change in sales volume of homes by property price (from Jan 2013 to Jan 2014) was as follows: homes < $100,000 (-19%), $100k to $250k (-6%), $250k to $500k (+4%), $500k to $750k (+15%) and $750k to $1mm (+19%).

City Then Job

Deloitte reports the 2010 U.S. Census shows 67% of college graduates aged 25Ys to 34Ys decided where they wanted to live first and then looked for a job in that city.

CEO Reporting

A group of scholars (Guadalupe, Li and Wulf) finds the size of the executive team reporting directly to the CEO has jumped from 5 (in 1980) to 10 now.

Customers

Research by comScore Networks finds 70% of consumers say they are more likely to use a local business if it has information available on a social media site like Facebook or Twitter. Tell your clients.

Better Savers

A Northwestern Mutual study finds people who turned 18 after 2000 are more disciplined savers than their grandparents (62% are highly disciplined or disciplined financial planners vs. 54% for those over 60Ys old). In good news for community bankers, 68% of this group of potential customers also said they had room for improvement in how they manage their money.

More Social

The Deloitte Globalization Survey 2013 finds 61% of executives surveyed worldwide expect social media will become somewhat or much more important to their business over the next 3Ys (vs. 36% in 2012 and 18% in 2011).

Much More Social

The Deloitte Business Trends 2014 report finds the total global social media audience soared 18% in 2013 to 1.73B, or about 25% of the total worldwide population. The top 3 global social media platforms in order are Facebook, YouTube and QZone (China). Of interest, 86% of Facebook users are outside the U.S.